VALUATION I

LESSON THREE - AN INTRODUCTION
TO THE COMPARATIVE
SALES METHOD
OF VALUATION

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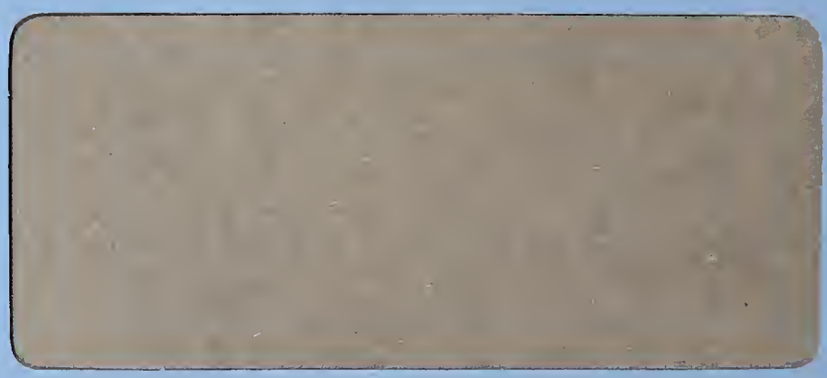

ASSESSMENT TRAINING PROGRAMME

VALUATION I

LESSON THREE - AN INTRODUCTION TO THE COMPARATIVE SALES METHOD OF VALUATION

Ontario

MINISTRY OF REVENUE

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NOTE: Appraisal Notes for the Assessor by A.N. MacKay is the Valuation 1 Course text. This book is considered as being the best treatment of appraisal theory for assessors and everyone should acquire a basic familiarity with its contents.

PREFACE

The material contained in this publication is for instructional purposes only. In no way should it be construed as representing the official position of either the Assessment Division or the Ministry of Revenue, on any of the topics covered herein.

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THE COMPARATIVE SALES METHOD

The comparative sales method is based on the comparison of sale prices of similar properties in a generally homogeneous neighbourhood, within a reasonable time span. This method is often referred to as the market data approach to value since it uses data from the real estate market itself to arrive at estimates of value. As in the case of the cost method, the comparative sales method is also based on the principle of substitution which states that a knowledgeable buyer will not pay more for a given property than he must pay for a substitute property offering similar uses, similar utility and similar functions.

The comparative sales method is based on a direct study of recent sales data. Similar properties tend to have similar sale prices. Hence this method involves selecting several sales of comparable properties for each property to be valued and then subjecting this data to a sales analysis so as to arrive at an estimate of market value, for the unsold property.

The Comparative Sales Method and Assessment

The "textbook" application of the comparative sales method is time-consuming. In mass appraisal, this type of procedure is seldom applicable, since as a rule there is not enough time to deal with individual properties in great detail. The Assessment Division, however, is using this method for valuing condominium units. The homogeneous nature of condominiums lends itself well to this type of analysis.[1]

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[1] See Assessment Standards Procedure Paper - "Market Comparison for Condominiums" a copy of which is available at all Regional Offices.

The principles underlying this method apply to mass appraisal practice as well as to private appraisal. We shall deal briefly with them to illustrate how an estimate of value for a single unsold property using information from recently sold comparable properties is arrived at. Later in the lesson, we shall include in our discussion how computer technology can make the comparative sales method more effective in mass appraisal work.

The Two Steps

The two important steps involved in this method to value are the collection of genuine recent sales of similar properties and then analysing these sale prices to arrive at an estimate of market value of the unsold property.

Sales Data

Next to individual property data the major component in any programme of mass appraisal at current market value is accurate information on recent sales. Sales serve both as the basis of the comparative sales method to value, and as the only direct evidence of market value or most likely sale price. Consequently in market assessment recent sales play a predominant role in the compilation, testing and revision of value estimates. Sales are of absolute importance in the application of the comparative sales method to value; in estimating land values for all three methods; in computing gross income multipliers for apartment valuation; in constructing local modifiers and depreciation tables for use in the cost method; and as primary evidence in court. Also, recent sales provide the only way of acquiring the 'feel' or intuitive grasp of local markets that is the key to individual skill in real property valuation.

Sources of Sales Data

In Ontario there are two primary sources of data on recent sales. The first is the older 'Registry System' of title registration, and the second is the more recent 'Land Titles System'. Generally speaking under the registry system anyone can register a claim against any parcel of real property in Ontario. Under the land titles system

however, claims are researched by government officials before they are registered, and any registered claim is guaranteed by the Crown. Assessment offices in the province now receive copies of land registrations from both Registry and Land Titles Offices. In addition, a commercial organization known as 'Teela Market Services' sells sales data to both private and public organizations, based on information received at the Registry and Land Titles Office.

Verification: 'Good' and 'Bad' Sales

Records of transactions obtained from The Registry and Land Titles Offices should be 'verified' before being accepted as 'good' sales that accurately reflect the market value of real property. In slightly different language, some records represent transactions where the principal motivations of buyer and/or seller do not involve the worth of real property as a parcel of real estate devoted to a particular use. Transactions of this sort tend to misrepresent the market value of real property, and they should generally be excluded from analysis of sales data used to arrive at estimates of property values.

Sales verification is an important part of the mass appraisal process, particularly in a programme of assessment at market value. There are, however, areas of disagreement over what constitutes a valid sale in some instances. Where there is room for reasonable dispute, the best procedure possible is to follow a consistent practice. In other words, although individuals may disagree on the logic of particular cases, in practice everyone should agree to reject or accept sales on the same basis.

Types of Unacceptable Sales

There are at least nine general cases where recorded transactions tend to distort the market value of real property. They are:

a) non-arms-length transactions,
b) transactions involving property redevelopment or changes in use,
c) transactions which involve unusual financing,

d) transactions involving unusual leases,
e) legally forced sales,
f) deferred sales and options to purchase,
g) chattels or stock in trade,
h) business transactions involving special purchasers,
i) transactions involving limited interests.

a) Non-Arms-Length Transactions. In acceptable sales the principal relation between buyer and seller is an exchange relation associated with the market place. Lawyers describe this type of relation under the heading 'at arms length'. Transactions where the principal relation between buyer and seller is not an exchange relation associated with the market place, tend to misrepresent the market value of real property, and should be treated as unacceptable. Examples are transfers of property among members of the same family, transfers that represent outright gifts involving 'love and affection', and transfers within a single company or among related or subsidiary business organizations.

b) Transactions Involving Property Redevelopment or Changes In Use. In some cases buyers purchase improved property not as a combination of land and buildings devoted to a particular use, but as land or land and buildings suited to an alternative use. For example, an apartment developer might buy several, older single family homes as a site for a new apartment building. Or, a retail merchandiser might buy an old, central city factory as accommodation for a discount retail store. Transactions of this sort misrepresent the market value of real property for its present or current use. They also tend to misrepresent the value of property in the alternative use for which it is purchased, since they may not wholly take account of conversion costs associated with the demolition or remodelling of existing buildings.

c) Transactions Which Involve Unusual Financing. Since financing arrangements have now come to be an integral part of the sale of a property, it requires that such arrangements be considered as common

non-property factors influencing market value. To fulfill this requirement either of two approaches may be followed. The first is to treat market value as most likely sale price, assuming typical financing[1] for the type of property in question. In practice this involves determining the type of financing that occurs most often in a given area, and then excluding transactions where financing is significantly different from the typical practice.

The second approach to the problem of financing is to discount particular transactions, so that all sale prices are expressed in terms of 'cash to vendor'. For example, if property A sells for a total price of $15,000 which includes a down payment of $3,000 and a first mortgage of $12,000 held by a trust company other things equal, the total cash received by the vendor will be $3,000 + $12,000 = $15,000. On the other hand, if property B sells for a total price of $15,800 which includes a down payment of $1,000 and a first mortgage of $12,000 held by a trust company, and a second mortgage of $2,800 for 5 years at 12% a year, held by the vendor, the total cash received by the vendor at the time of purchase will be $1,000 + $12,000 + the present value of the second mortgage.

If an active market for second mortgages exists, present value can be estimated by analyzing recent sales of comparable mortgages. Where market evidence is scarce present value can be estimated using discounting techniques. For example, let us assume that the second mortgage outlined above involves five annual payments of $560, for instance, Table 18 in Appraisal Notes for the Assessor[2] indicates that the present value of $560 a year for 5 years at 12% annual interest is $560 X 3.60 = $2,016 or $2,000 rounded to the nearest $100. On this basis, in the case of property B, the total cash received by the vendor is $1,000 + $12,000 + $2,000 = $15,000. Or, $15,000 is the price of property B in terms of cash to vendor, although $15,800 is the price that actually appears on the document of registration.

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[1] See pp. 34-35 of Appraisal Notes for the Assessor for an example of transaction adjustment to reflect market equivalent.

[2] The use of these tables will be explained fully in Lesson 4 - An introduction to the Income Method to Value.

Both 'typical financing' and 'cash to vendor' have advantages and disadvantages. The important point is that either one or the other should be chosen, and then followed consistently. Typical financing has the advantage of simplicity, and it usually takes less time to apply. Cash to vendor is more precise, at least in theory, and it avoids the need to exclude or 'throw out' sales which might be in short supply.

d) Transactions Which Involve Unusual Leases. The problem of leases is analogous to the problem of mortgages or financing arrangements. As in the case of financing arrangements, either of two approaches are possible in dealing with sales of rental properties that involve different types of leases.

In the first place, market value for assessment purposes can be treated as most likely sale price, assuming typical leasing arrangements for the type of property in question. For example, if most stores of a certain kind have ten year leases that are only half expired, then sales of comparable properties with significantly different leases should be treated as unacceptable. In practice most real property leases negotiated in the last few years include fairly short terms. Consequently, any sale of property with a long-term lease that is only partially expired, should be scrutinized carefully, since it is likely to involve an unusually low price as a result of low rents in the leasing contract.

The second approach to the problem of leases involves treating market value for assessment purposes as most likely sale price, assuming current 'economic' rent, or leases that are renegotiated at the time of sale. Sales of properties with old leases only partially expired, or properties where the 'contract' rent is significantly different from what it would likely be if the lease were renegotiated at the time of sale, should be adjusted to reflect current market conditions, or treated as unacceptable and excluded from use in real property valuation.

e) Legally Forced Sales. In some transactions real property is exchanged under legal sanctions without which an exchange would not take

place. Or, the principal motive for exchange involves legal coercion on the part of either buyer and/or seller. Transactions of this sort tend to misrepresent actual real estate values and should be treated as unacceptable for purposes of real property valuation. Examples include expropriations, mortgage foreclosures, tax sales, liquidations, and bankruptcies.

f) Deferred Sales and Options To Purchase. In some cases transactions involving real property are not registered for several years after they take place. For example, sales of houses that include a small down payment and large mortgage are occasionally left unregistered until a substantial portion of the mortgage has been paid off. On this basis a sale which took place in 1951 might not be registered until 1970. Consequently in examining registered documents it is important to look for the Date of Sale and Not the Date of Registration

In a related vein registered documents sometimes involve 'options to purchase' rather than an actual exchange of real property. Options to purchase provide misleading evidence of market value both in the sense that stated prices are not necessarily those which will prevail when purchase actually takes place, and in the sense that they provide no guarantee of an actual exchange of real property either now or in the future.

g) Chattels or Stock In Trade. Some sales of real property include chattels or personal property. As a rule transactions of this sort misrepresent the market value of real estate as real estate, and they are inadmissable in court for assessment purposes since personal property is not taxable. Sales of cottages and condominiums, for example, often include furniture and appliances like stoves or refrigerators. Although in some cases chattels do not add a significant amount to property value, allowances must be made for any elements of personal property included in a real estate transaction, and where this is not possible, the sale should be treated as unacceptable.

h) Business Transactions Involving Special Purchasers. In many cases exchanges of real estate involving special motivations

associated with business organizations tend to misrepresent the market value of real property. For example, if a department store buys an adjacent property for purposes of expanding store facilities, its motivations tend to centre about the need for expansion rather than the worth of the adjacent property as a piece of real estate in its own right. On this basis the price paid is likely to be distorted, and it is good practice to regard sales of this sort as unacceptable for purposes of real property valuation.

A similar situation sometimes exists in the case of the last parcel of land purchased in a private land assembly project. For example, as an assembly project draws to a close there may be several parcels of land available, only one of which is 'needed' for completion of the project. As a rule, the price which this 'last' parcel brings will be an unreliable guide to the likely sale prices of the remaining unsold parcels.

i) Transactions Involving Limited Interests. Some registered documents represent only limited interests in real estate, rather than a complete exchange of the rights to real property. For example, people often register mortgages, 'mechanic's liens' and a variety of easements and restricted covenants. Documents involving matters of this sort should not be mistaken for sales of real property.

A related situation exists where the purpose of registration is simply to clarify the legal status of a given parcel of real estate. In this context some registered documents are only designed to clear title or 'quit claim', and do not represent a genuine exchange of property.

Methods of Determining Unacceptable Sales

Roughly speaking there are two methods of determining unacceptable sales. The first is to scrutinize documents from the Registry and Land Titles Offices, while the second involves the actual physical inspection of sold properties and direct interviews with knowledgeable parties.

In some cases inspection of registered documents provides enough information to determine whether a sale is acceptable. This

is often true in the case of non-arms-length sales, sales involving unusual leases or financing arrangements, some types of legally forced sales, deferred sales or options to purchase, some types of sales that include chattels, and registrations involving limited interests. In other cases verification is only possible through physical inspection of sold properties or direct interviews with buyers, sellers, real estate agents, or other knowledgeable parties. This is usually true in the case of sales associated with property redevelopment or changes in use, some types of sales that include chattels, and business transactions involving special purchasers.

Sales that seem acceptable at first glance can sometimes be checked by applying several 'rule of thumb' tests. Property prices that appear unusually high or low with regard to the size, age, and location of comparable properties, for example, often prove to be unacceptable and should be reviewed in greater detail. Similarly, property prices that end in odd numbers sometimes indicate unacceptable sales involving mortgage foreclosures or limited interests. Tests of this sort alone are <u>not</u> enough to determine whether a sale is unacceptable, but they do suggest that the transactions concerned warrant closer scrutiny.

In mass appraisal it is not always possible to spend the amount of time on sales verification that is usually taken in private valuation work. And, on occasion it is necessary to draw some compromise between the need for completely accurate sales data, and the demands of valuing large numbers of properties in a fairly short space of time. At the very least, however, sales should be verified with the greatest degree of care and accuracy possible in the available time. In most cases poor quality in sales verification is closely related to poor quality in mass appraisal as a whole.

A regular system of entering <u>verified sales</u> from Registry and Land Titles Offices in the columns provided for, on standard appraisal cards, is highly useful for selecting sales of comparable properties in assessment work. For certain purposes it is also useful to record sales data on small cards that are easily processed by hand.

The advent of the Valuation File which is closely linked with the availability of valid sales data, makes the need for accurate verification of sales even more important.

For purposes of identifying the type of sale once it has been effected, a table of codes was devised in 1968/69, for use in all regional assessment offices. The following is a list of the codes:

CODE	CLASSIFICATION
00	Open Market sale.
01	Family sale.
02	Forced sale.
03	Quit claim or Clearing a title.
04	Speculative sale.
05	Government or Exempt property transaction.
06	Sale including Crops, Chattels or Goodwill.
07	Bush or Wood Lot - sold for trees.
08	Sales involving changed property use.
09	Sales based on Non-typical Financing.
10	Single sale price and/or Assessment for several properties.
19	Other.

Special Problems in the Verification of Farm Sales

The transitional nature of Ontario agriculture creates special problems for the verification of farm sales. Generally farm sales should be verified using the same procedures as used for other types of property. Two classes of unacceptable farm sales, however, arise with unusual frequency. The first class deals with sales involving changes in use, and the second concerns chattels or stock in trade.

With regard to changes in use, it is usually wise to check any sale of farm land involving a person or persons whose usual occupation is not farming. In like fashion the prices of farm land close to major urban centres invariably reflect some anticipation of urban development, and do not represent the value of land for farm purposes alone. Generally, in Ontario the special provisions of Section 27(3) of the Assessment Act make it especially important that farm sales

are carefully scrutinized to ensure that they reflect the value of land for farm use only.

In a related vein sales of farm property that include livestock, machinery, tobacco rights, milk contracts, or similar marketing devices will usually involve higher prices than sales of similar properties without these arrangements. Since farm sales data is sometimes in short supply, where possible it is convenient to adjust sale prices involving special marketing arrangements rather than exclude them completely from valuation work. Shortage of farm sales data can sometimes be alleviated extending the period for which data is collected beyond the length of time regarded as acceptable in the case of urban properties. The reasoning behind this is that markets for farm land <u>as farm land alone</u> often tend to be less active than markets for other kinds of property.

PROPERTY CHARACTERISTICS ASSOCIATED WITH VALUE

Similar Prices: Similar Properties

At a given time and place, a market sets similar prices for similar properties according to certain conditions, the most important being a large proportion of well-informed buyers and sellers. If enough buyers are reasonably well-informed about the prices of comparable properties, sellers have to 'take' similar prices for the properties that they sell. Even where there are only a few sellers the prices of similar properties will tend to be similar, although the prices will likely be higher than where more sellers are present.

Markets with only a few sellers and many buyers are most common in the case of bare land or newly improved properties, especially new houses. Markets for older improved properties tend to involve more equal numbers of buyers and sellers. Especially strong demand for relatively scarce older properties can create a 'sellers' market', where sellers are in a better bargaining position than buyers. Alternatively, weak demand for abundant older properties can create a 'buyers'market', where buyers are in a better bargaining position than sellers. In both cases the prices of similar properties will tend to be similar. As a rule, prices will be evenly higher in sellers' markets and evenly lower in buyers' markets.

If there are few buyers and few sellers, the prices of comparable properties will likely be less similar than where the number of buyers and sellers is fairly extensive. Generally, the presence of only a few buyers and sellers increases the chance that hard bargaining will play an unusually important role in price-setting. In other words, where the market for a given type of property is limited, the prices of physically similar properties are likely to be less comparable than in markets where that type of property is more easily available.

Since people make value, properties are, for all practical considerations the same, if they are alike with regard to characteristics that buyers and sellers regard as important. For example, two houses which are alike except for different colours on the front door

can be treated as virtually identical, since buyers will seldom regard the colour of the front door as important enough to influence the price that they are willing to pay for a house.

Some general classes of real property exhibit more similarity than others. As a rule, for instance, there are more similarities among residential than among commercial properties. And, within the general residential class there are more similarities among medium-sized properties than among very large or very small ones. Naturally the characteristics that buyers and sellers regard as important in determining similarity will also vary among general classes of property. Although the number of bedrooms is important in the case of residential properties, it obviously doesn't apply in the case of retail stores. In like fashion although soil productivity is very important for farm properties, it indicates little about similarities among small houses.

Grouping of Property Characteristics

Usually properties are similar if they are alike with respect to characteristics that have an important influence on price or value. Consequently, in order to apply market valuation techniques it is important to have some knowledge of characteristics closely associated with the market value of real property.

Generally different characteristics are associated with the value of different types of property. Certain basic features, however, are common to all parcels of real estate. We will briefly discuss these common features, and at the same time attempt to take note of some special characteristics for important property classes.

1. Transaction Characteristics. Transaction characteristics are associated with an exchange or sale of property and not with real property itself. They include the date or time of sale, the financing arrangements, and any special factors involved in the act of exchange. Assuming that financing arrangements and other special factors have been allowed for in the sales verification process, as discussed earlier, the most important transaction characteristic apart from the price, is the date or time of sale.

In general, sales that took place in the fairly distant past are unreliable guides to current market value. In property tax assessment it is important to isolate time periods during which the money prices of similar properties are relatively stable. Acceptable lengths of time will vary for different places and types of property. Where markets are very active, sales taking effect more than six months from the valuation date or time at which value is estimated might be misleading. On the other hand, in relatively 'stagnant' markets, sales that are two years old or more, might provide useful evidence of current value.

2. Site Characteristics. Site characteristics relate to the lot or actual 'land' that forms a part of both improved and unimproved property. Generally, the site characteristic most closely associated with price or value is size, and this is measured in terms of acreage, square footage, or frontage and depth, depending on the type of property in question. Other site characteristics also associated with market value are zoning, topography, shape, and provision of local services.

In the case of farm properties, a special site characteristic closely associated with value is capacity of land for agricultural use. In like fashion, a related situation sometimes exists in the case of sites for large buildings, where deep sandy soil or underground creeks and streams increase the cost of constructing adequate foundations.

3. Building Characteristics. In almost all cases the two building characteristics most closely associated with price or value are size and age. Quality and character of construction can also be important, although not to the same extent as building size and building age.

4. Neighbourhood or Locational Characteristics. The neighbourhood or location of a property is closely related to its market value. For example, two houses with similar site and building characteristics might sell on the same day for quite different prices if one is in an expensive 'executive' neighbourhood, while the other is in a

run-down district on the edge of a large meat-packing plant. In like fashion, two identical retail stores might also sell for different prices if one is on a major commercial artery, while the other is on a residential side street with only local traffic.

The exact nature of neighbourhood or location characteristics depends on the area or region in question. For this reason it is often helpful to design maps of comparable neighbourhoods or locational groupings for use in applications of the market sales method.

As a rule, division into neighbourhoods in the strict sense of the term applies only to residential properties. In the case of commerical and industrial properties useful measures of locational advantage can sometimes be devised by calculating distances from major 'landmarks' like important highways or popular shopping districts. Important locational characteristics for farm properties include distances from major centres and proximity to paved roads.

Generally determining particular neighbourhood or locational characteristics involves a good knowledge of local real estate markets and some appreciation of the social milieu and business character of the area or region in question and finally, the ability to relate those facts of real estate to the habits of everyday living in its broadest sense.

The Selection of Comparables and Adjusting for Non-Comparable Characteristics

The first step is to select recently sold properties that are comparable to the subject property being valued. To the extent that the selection of comparables is done well, price adjustments allowing for non-comparable characteristics are straightforward. On the other hand, if the selection of comparable properties is not reasonably similar to the subject property, an attempt at price adjustments is not likely to produce a reliable estimate of value. Also, if the process of adjustments becomes too elaborate, this will indicate that the initial selection of comparables was not sufficiently accurate, or if there is a wide discrepancy in sale prices of comparable properties, it might suggest that neighbourhood boundaries need further scrutiny.

Certainly, general and local market conditions for a given neighbourhood, might influence like characteristics to a lesser or greater degree, but in most instances, the following characteristics are considered the more important ones for selecting comparables. They are:

1) date of sale,
2) site area,
3) building area,
4) building age and condition,
5) building style,
6) number of bathrooms,
7) garages, and
8) neighbourhood quality.

Once these comparable properties have been identified and grouped together and a sales verification analysis completed for the same, the next step is to make the necessary adjustments to arrive at an estimate of value for the unsold subject property.

The adjustment stage is based on the recognition that all properties, no matter how similar, possess some unique attributes which must be taken into account when estimating their market value. If the most likely selling price of an unsold property is to be found, adjustments must be made for the dissimilar attributes.

There are several techniques of adjustment used in the traditional market data method: The Dollar Method; The Percentage Method; and The Factor Method. Since these methods are primarily directed to appraisal application, rather than for assessment purposes, we refer you to any regular text, which review these methods at some length.

As a rule the safest method of making adjustments is to attempt an imitation of typical buyers and sellers in the market place. Typical buyers and sellers seldom have a detailed knowledge of building construction or real estate market trends, and they usually consider only a few basic factors in their decisions to buy and sell. On this basis, simple adjustments based on characteristics

that are clearly related to market value are most likely to approximate what actually takes place in real property markets. For characteristics of comparable properties that are inferior to the subject property the method of adjustment is to add dollar amounts to the comparable property, and subtract dollar amounts from the comparable property, for characteristics that are superior to the subject property. The admustments ultimately result in a set of 'adjusted prices' for comparable properties. Once this has been done, market value for the unsold subject property is estimated on the basis of an averaging of the adjusted prices. One should not expect to arrive at an identical adjusted price, because in practice real property markets tend to set a range of similar prices for like properties rather than a single amount.

Uses of The Comparative Sales Method

Since the comparative sales method works with direct evidences of value provided by real estate markets, it is generally regarded as the most reliable of the three methods. At present, the most important function of this method in real property assessment is to estimate land values, for use in conjunction with estimates of building value derived through the cost method.

The principles behind the comparative sales method also play an important role in developing local modifiers and empirical depreciation tables associated with the cost method. Also, market-oriented techniques are fundamental to the development of gross income multipliers which are often used in the valuation of apartment buildings. It is clear that recent sales of comparable properties will play a major role in appeals of assessments at current market value.

However, for obvious reasons, where recent sales of comparable properties are unavailable, the comparative sales method is virtually impossible to apply.

SITE VALUATION

The comparative sales method is the only general method of land valuation suitable for mass appraisal. However, this method can only be applied effectively, if there are sufficient 'open-market' sales within a given defined neighbourhood and within a reasonable time period. Since the greatest volume of sales is to be found in residential properties, we shall concern ourselves in this section of the lesson, to analysing mainly residential site valuations.[1]

Sources of Market Data

The primary source of market data will naturally be recent valid sales of individual vacant serviced lots. In the absence of such sales, the sale price of raw land could be added to the subsequent cost of servicing the land to arrive at an equivalent price of a vacant serviced lot. The same principle could be applied in the case of property sales with obsolete improvements. Here, the estimated cost of demolition can be added on to the sale price to produce the same result.

Correct rental data can also be used as a basis for comparison in developing site values. In instances where the improvement is recently constructed and for which construction costs can be accurately estimated, such estimated costs can be deducted from the sale price to give an estimate of the site as if vacant. In similar instances, but where depreciation allowance and local modifiers have to be applied, the resulting value estimate is the least valid, but nevertheless it could be used as a last resort or as a means of cross-checking site values produced.

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[1]The discussion to follow has been based on "A Site Valuation System" outlined in "The Policy and Directives Manual", issued by The Executive Directors Office, Assessment Division, in May of 1974. For a further study on site valuations regarding Multi-Residential properties, Specific properties, Commercial sites, Farm land and Industrial sites you are referred to pp. 58 to 90 and pp. 143 to 145 of the same manual. A copy of the manual is available in each Regional Office.

In the case of residential site valuation, where a sale involves multiple lots, an upward adjustment to the average lot price will have to be included to reflect the quantity discount allowed for bulk purchase. Estimates of the size of discount may be obtained from an analysis of individual lot sales or other subsidiary sources, such as the application of the Land Residual Technique,[1] and discussions with real estate brokers, developers and appraisers. In the absence or the lack of sufficient sales data for a particular neighbourhood, sales data for vacant unimproved lots from other municipalities may be utilized, provided the assessor is convinced that, in the area for which unimproved site sales data is available, similar residential properties are selling for similar prices.

Guidelines for Defining Neighbourhoods

For purposes of analysing sales data, all municipalities should be divided into neighbourhoods, having full regard to local zoning regulations. To demarcate neighbourhoods, a thorough visual inspection of the municipality is essential, together with an analysis of all other available related information. It will be seen that certain geographic and social criteria will strongly influence the boundaries of neighbourhoods. Usually people within the same salary bracket are inclined to congregate together and within this general area, houses will tend to be homogeneous in character. They are generally constructed at about the same time and are similar to each other in size, architectural design, quality and type. The site services provided will be relatively consistent; as also will the transportation facilities, the type and quality of public amenities and the general topographical layout.

Where sales information for improved properties is available, comparable houses should fall within a similar range of sale prices,

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[1] The Land Residual Technique has previously been dealt with, pp. 23-24 of Valuation One--Lesson Two--An Introduction to The Cost Method to Value.

in a given neighbourhood. If prices for similar properties within that neighbourhood differ sharply, that would indicate that certain influences are causing these fluctuations. They must then be reviewed, and based on the findings, the neighbourhood boundaries should be reorganized.

Neighbourhood Tables

When the demarcation of neighbourhoods has been completed, landmarks such as parks, schools, shopping centres, central business district, factory areas, etc., that may have an influence on value should be plotted on an assessment map. Also, all valid vacant land sales as well as sales of improved properties, should be inserted at the respective lots on the map. Through a physical inspection and with the help of the map and information on the appraisal card, characteristics of the properties, and the amenities within each neighbourhood must be carefully noted and compared, especially with the neighbourhood which has the most number of vacant land sales. A neighbourhood rating system is then developed with this comparison, allowing vacant land sales to be the major determinant of the rating system. Neighbourhoods falling within the same rating are grouped together and the number of groups will determine the number of neighbourhood tables to be prepared.

Neighbourhood tables[1] are prepared through a detailed analysis of sale prices. They result in median sale prices for given ranges of lot sizes. Furthermore, sale prices will indicate the trend or rate at which values change for given changes in lot sizes. This value change is expressed as a percentage and applied to the median sale price for that given range of lot size to arrive at an adjusted site value.

Within the framework of this system, there will be individual lots which due to unusual circumstances may demand individual adjustments. In these cases, adjustments (for a ravine lot for example) will

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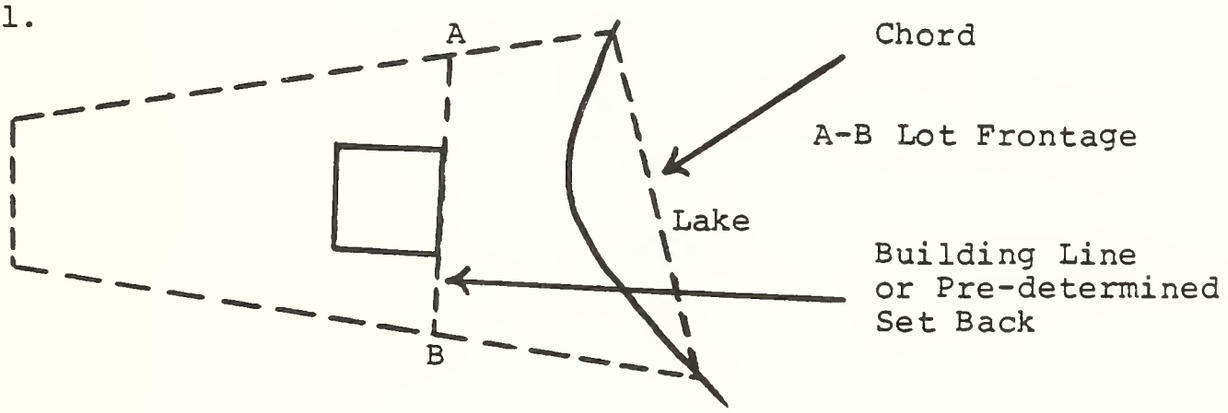
[1] For a detailed procedure on the methodology for preparing neighbourhood tables, you are referred to pp. 50-57 of The Policy and Directives Manual.

have to be made by assessors in the field but as far as possible must be substantiated by sales data.

Non-Urban Properties

Water front lots are usually purchased by the front foot, and hence, the frontage of a particular lot should be considered the major determinant of the site value. To calculate the frontage of an irregular water front lot, the frontage must be calculated as the width of the lot at the building line (see Figure 1) or, where the actual building line is not known, by a pre-determined policy as established by the regional commissioner, for example, the chord might be used.

Figure 1.



Second and subsequent tier summer properties lot values are not so dependent on the frontage as first tier lots and should be calculated on a site basis using all available sources of market data.

The valuation of lots in villages and smaller urban centres may not justify the preparation of neighbourhood tables. An individual valuation of lots by an assessor, guided by any market data which may be available, including data from similar economic areas, is probably the best method.

Rural and Semi-Urban Residential, Estate Holdings should be valued as a complete site unit, with considerations given to size, location and the desirability of the property. As with urban lots, however, all valuations are to be substantiated as far as is possible by sales data.

Individual Lot Considerations

In cases where outside factors may influence the value of an individual site or sites, reductions to the value of a site as a result of economic obsolescence, should be made only, if the reduction can be substantiated by market data.

In cases of improved properties where data indicates that the dollar value of any economic obsolescence is such that the value of the site has to be reduced to zero or even a negative value to produce a realistic value estimate for the property, then the economic obsolescence will be apportioned between the site and the improvement. The site value should be reduced to a value indicated by its highest alternative use, and the remainder of the economic obsolescence should be deducted from the improvement.

Any obsolescence attributable to over or under-improvement of the site must be deducted from the improvement.

Semi-detached houses should be valued as two separate lots. In situations where semi-detached houses fall under one ownership, and where zoning doesn't allow the lot be severed, then the site should be considered as a single lot and valued accordingly.

COMPUTER-ASSISTED MARKET ANALYSIS

As indicated earlier, since assessors must value large numbers of properties in a relatively brief period of time and must be prepared to defend their assessments in court, there has been a tendancy to concentrate on techniques which could be demonstrated to have a high degree of consistency among both individual properties and property classes. Hence a heavy reliance has been placed on the cost method of valuation. However with the introduction of computers and statistical techniques into the property assessment field reference is gradually being directed towards these modes in estimating market value by the comparative sales method.

The process simply involves an attempt to substitute statistical methods for the kind of mass appraisal framework that, until recently only the cost method seemed able to provide.

Aims of Computer-Assisted Method

The application of statistical techniques to the comparative sales method to value is not a 'computer valuation system' as most people are led to believe, rather it is an adaptation of the standard market valuation method that usually employs computers to sort data and make calculations quickly. Or, to say the same in another way, the statistical method simply provides a framework within which experienced people can interpret local real estate markets and arrive at reasonable estimates of market value.

To clarify this point further, some people imagine that where computers are involved 'machines' do all the work. If anything at all, introduction of these new techniques, places a greater premium on human skill and judgement than other mass appraisal methods, since it requires careful interpretation and adjustment to produce reliable results. For the present time, these computer-assisted techniques seem most suited to residential valuations, although research is in progress to make it useful for other kinds of properties where market data is readily available.

The term 'market value' as defined in The Assessment Act, makes it abundantly clear that any proper assessment must reflect the assessor's consideration of real estate market activity. Indeed an assessment which has been arrived at without due attention to sales will not hold ground in the courts.[1] Therefore it is essential that the assessor have easy access to sales information in order to arrive at fair market values, and to defend them in courts. Hence, the goal of the computer-assisted techniques is to aid the regional offices in their attempt to recognize and analyse trends in market activity more rapidly and efficiently than they can at the present time.

Creation of The Valuation File

With this end in mind, research and gradual implementation has been underway for some time to develop a computerised Valuation File which will contain data on every property in the province. With this automated system, the regional offices will have access to the massive data base and data manipulation facilities of the computer, thereby alleviating the serious handicaps that the assessors face in maintaining market values.

The Valuation File will contain almost all the information that is presently on the appraisal cards and will provide assessment personnel with the facility to obtain outputs indicating relevant physical, financial and locational information for every property record; sort properties into groups of comparables on the basis of these characteristics; make simple calculations, such as local modifiers and depreciation tables, estimates of dispersion and other statistical measures; and use multiple regression techniques to arrive at value estimates. When completed, the valuation data base will be the most comprehensive source of information on real property in North America!

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[1] See Office Specialty Ltd. vs. The Regional Assessment Commissioner Region No. 14 (1973) 1 O.R. 181

MINISTRY OF REVENUE LIBRARY

Advantages and Limitations

Above all, the computer-assisted programme will allow the mass appraisal process to work directly with market data. With the help of such a data base, computation will be performed faster with fewer mistakes and at a lower unit cost. The quality control function will be greatly facilitated; it will be able to perform quality control at several levels and to take into account the nature of the market. Computer reports on assessment to sale price ratios will detect individual suspect assessments as well as groups of properties which are presenting particular problems. More frequent updates will be possible, in addition, the ability of such a data bank to generate reports of comparable properties on a wide variety of criteria will be of vital importance in the preparation of cases for assessment appeals. The uses will undoubtedly increase with the passage of time and as the assessors familiarize themselves with its operations.

A major problem in the application of computer and statistical techniques, is the amount of work associated with preparing sales and property data. The computer-assisted method is highly sensitive to data errors, inadequate sales verification and sloppy and irregular recording procedures. At the same time however, once sales and property data have been accurately recorded and stored away in the data bank, they provide a continuing source of readily accessible knowledge on real estate markets and property values. Mass appraisal using market valuation methods is still in its infancy in Ontario, and it contains many rough edges that can only be smoothed out as more experience is gained while using these new techniques at different times and in different places.

Quality in Mass Appraisal

The test of the new technique will, of course, be a qualitative one. The recognition that real property markets set not a single price for similar properties, but a range of prices, is an assumption basic to the new market method. In private appraisals valuation quality is usually judged on an individual basis. In mass appraisal, judgements about individual quality are both impractical

and relatively meaningless. Roughly speaking, one assessment or mass appraisal is better than another when more properties are valued within acceptable limits of accuracy. For example, if individual values fall within a given percent of some accepted index of market value 90% of the time in one case, and only 75% of the time in a second case, then the first case represents a better mass appraisal than the second.

In slightly different words, a mass appraisal that is quite good on the whole although poor in isolated cases can be patched up in the courts. Yet a mass appraisal that is poor on the whole creates virtually insoluble problems, no matter how accurate isolated individual values might be. This is a very simple point, but one that is easy to forget. Mass appraisal invariably has trouble with unusual, individual cases. The real test of quality is whether or not the overwhelming majority of properties are valued as accurately as possible

Theory of the Computer Method

The computer-assisted method includes the same two basic steps associated with the standard market valuation method, namely, the selection of comparables, and the creation of adjustments for non-comparable characteristics. The major differences between the two being, firstly, that the selection of comparables in the computer method is done on a much broader basis, and involves the isolation of generally similar property classes rather than the selection of individual properties that are almost identical, and secondly, the adjustment process in the computer method centres about a statistical technique known as 'regression analysis'.

The First Step

As stated above, the principle of this step parallels the selection of comparable sales in the standard market data method. However, while selecting groups of sales of roughly similar properties, one must bear in mind that the purpose of this process is to isolate groups of properties within which relationships between sale price and property characteristics are as regular as possible. Furthermore,

each group should include approximately a hundred sales. This requirement is designed to ensure that relationships between sale price and property characteristics established for each group can be reliably applied to properties that have not sold. As a result of this rule of thumb, the number of groups which can be constructed for a given time and place depends on the number of sales available. So, to the extent that only small numbers of sales are available, relationships between sale price and property characteristics within each group are likely to be less regular than where the number of sales is large.

The Second Step

Once property groups have been identified, the next step involves establishing relationships between sale price and property characteristics for each group of roughly similar properties. The relationships for a given group form what is called a 'valuation model'. As mentioned earlier, valuation models can be prepared using a statistical technique known as 'multiple regression analysis'.

Multiple Regression[1]

For the purposes of this lesson, we shall attempt here, to give a brief outline to the theory of multiple regression. The theory behind this technique is to use the prices of sold properties to estimate the probable selling prices of unsold comparable properties. Since it uses actual market data to arrive at market value it reduces the degree of subjectivity on the part of the assessor, and thus eliminates the possibility of bias entering into the values.

By analysing a sample of sales data in a given neighbourhood, the assessor can identify and isolate those property characteristics that have a significant influence on sale price. For example, in a typical middle class neighbourhood, characteristics such as

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[1] This topic will be discussed in depth at the seminar.

building area, number of bedrooms, number of bathrooms, age of building, parking facilities, may have a greater influence on sale price than say, the type of heating, the height of the basement, the number of porches, etc. The computer further assigns to each property characteristic, a weight or dollar value, which measures the amount of effect that, that particular characteristic has on the sale price. To clarify this further, let us suppose that a factor of 8 is attached to floor area in a given neighbourhood. This indicates that a 1000 sq. ft. house in that neighbourhood, contributes $8,000 to the sale price, and similarly a 1,200 sq. ft. house contributes $9,600 to the sale price. In like manner a weight of -20 assigned to building age would indicate that a building 15 years old should be valued $300 less than a new structure, all other things being equal.

A Simple Multiple Regression Example

Let us presume that for a certain neighbourhood, multiple regression analysis has produced the following regression equation:

Estimated Sale Price	=	$9,000
+ Floor Area	=	+ 8
+ Bldg. Age	=	- 60
+ No. of Bath.	=	+ 500
+ Date of Sale) in months)	=	+ 150

Applying this regression equation to properties located in the above neighbourhood (or within a defined range of applicability of the equation), 12 years old, having floor areas of 1,100 sq. ft., 2 bathrooms, and selling in June (6th month), would have estimated selling prices of:

Sale Price	=	$9,000
Floor Area	=	+ 8 x (1,100)
Bldg. Age	=	- 60 x (12)
No. of Bath.	=	+ 500 x (2)
Date of Sale) in months)	=	+ 150 x (6)
Estimated Sale Prices	=	$18,980.

Multiple regression analysis, therefore, attempts to establish a relationship between sale price and the factors that are deemed to influence sale price in the form of an equation showing sale price equal to the sum of a number of weighted values of the property characteristics. Such an equation is called the regression equation, and it can be used to estimate sale prices of unsold properties within that neighbourhood.

Graphical Analysis[1]

Graphical analysis is a non-automated comparative sales method of valuation. It is a simple procedure-oriented technique, which the assessor can understand and apply, and which produces comparable degrees of accuracy as the more complicated regression analysis technique. By means of plain graphical representations of data, the assessor can establish values for typical benchmark properties and determine adjustments for properties having characteristics different from these benchmark properties. The technique is envisaged as working best on a geographical organization where each assessor would be totally responsible for the valuation of a particular geographic neighbourhood.

The Assessment Standards Branch is presently conducting a pilot project using graphical analysis. Depending on the degree of success of the project, the graphical technique might well serve as a basis for the valuation of every region in Ontario at a future date.

Perhaps the most significant impact of this technique, if used, would be, that it would make assessors think in terms of market value rather than the traditional cost method which they have been accustomed to. Equally important, graphical analysis would involve the assessor directly in the total valuation process, and at the same time create the background for his introduction to the more sophisticated computer-assisted techniques, which may be used in the near future.

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[1] A detailed explanation of its working will be conducted at the Seminar.

MARKET VALUES WHERE THERE IS NO MARKET

The Scope of Special Valuations

Under the terms of The Assessment Act, special valuation methods of one kind or another are applied to a broad range of transportation and communication properties, generally referred to as Special Assessment Properties.

This group of properties includes railways, and other transportation systems, the properties of suppliers of water, heat, light and power, the pipe lines for the transmission of oil, gas and other liquid-state substances and telegraph and telephone companies. In addition to private enterprises, special provisions govern the assessment of public utilities and the Hydro-Electric Power Commission of Ontario.

Toward a Tentative Definition

In trying to develop a broad working definition for special assessment properties, let us first explore some of the basic characteristics which differentiate them from other property categories. It seems fair to suggest on an empirical level that the very quality which justifies "special" valuation treatment for these properties lies in the broad ways in which they differ from other properties generally found in a municipality. These differences may be summarized in these principal ways:-

Firstly, the essence of this difference lies in the singular and often non-convertible functional character of these special purpose properties. The functional nature of special purpose operations - the provision of communications and transportation services, the supply of water, heat, electrical power, the treatment of wastes, the extraction of natural resources, the provision of recreation facilities etc. - makes extensive and unique requirements in the form of land and

structural holdings. Thus, railway operations, for example, demand rights-of-way whose unique dimensions render conversion for another purpose impractical. As well, yards, freight sheds, structures for communications and control facilities, workshops and others are required for logical and operational support. These properties, again, must be considered single-purpose on the basis of their physical features.

Secondly, a difference lies in the operational scope of these properties. The operational scope is determined by the special functional character of these properties which require that services be provided on an inter-municipal basis and beyond. This service scope in turn makes extensive realty holdings necessary.

Thirdly, a difference lies in the inter-municipal character of these properties. The services associated with transportation and communications enterprises generally ignore the political boundaries of municipalities. For various operational reasons, company resources are normally not distributed through all service points on a uniform basis. For this reason, the difficulties involved with the determination of the total value of a company's assets within a given municipality differentiates these properties from other property types.

Fourthly, the difference focuses on the disproportionately low social services demand levels generally associated with these properties. As a rule, special purpose properties do not demand the same level of social services which is directly proportional to their revenue contributions. For this reason industry spokesmen have argued that since railway rights-of-way, telephone and telegraph lines and transmission pipelines do not place the same demands on social services as other property types, they should be accorded preferential considerations. This raises a fundamental and philosophical issue to which we turn next.

The Rationale for Special Valuation

In light of the foregoing differences, it has been argued that the 'benefits received' principle attached to real property taxation becomes somewhat inappropriate to special purpose properties. By extension, this argument is saying that because the demand for services is not in direct proportion to revenue contribution, the application of special valuation methods is justified. But is this argument really tenable?

One counter-argument revolves around the concept of "public goods". By "public goods" is meant the type of social benefits which can be derived irrespective of contributions or need. Let us clarify this concept by contrasting it with the notion of "private goods". By "private goods" is meant the type of possession or benefits which are derived by way of the "exclusion principle". Thus, we are excluded from either the physical possession or direct enjoyment, or both, of a given good unless we complete the transaction through the accepted medium of exchange. As well, the "exclusion principle" so applied also allows us to choose the given good in exclusion of others.

By contrast, the allocation of "public goods" has been elevated above the normal operation of the market mechanism on account of their character and the nature of their benefits. Accordingly, all "public goods" are not subject to the constraints of the "exclusion principle" in that they involve "joint consumption". By joint consumption is meant that the enjoyment of given benefits is not mutually exclusive. In this, the simultaneous use of a highway, for example, neither entails exclusion nor the reduction of benefits. At the same time, "public goods" reflect an element of compulsion. In other words, wish to participate is irrelevant. So is the question of direct benefit. Thus, it is immaterial that we have school age children or that we endorse public education, or that we anticipate or actually derive benefit from compulsory education.

The fact that public education is accepted as a public good imposes the condition that we must pay for it. With this clarification, let us now return to the counter-argument stated in the outset of this section.

On the basis of this "public good" concept, which posits that derived benefits are independent of contribution and use, it seems valid to assume that since all municipal social services are "public goods" in the real sense, they should be funded irrespective of the extent of their enjoyment. Accordingly, an attempt to justify differential valuation methods for special purpose properties on the "benefits received" principle becomes quite untenable.

What, then, constitute some of the reasons which justify differential valuation methods?

The principal reason, it seems, lies in the difficulty involved in ascertaining "Market Value" ....is the amount that ....might be expected to realize if sold in the open market by a willing seller to a willing buyer". (The Assessment Act, 1969-1970, Section 27(2)). This is usually interpreted to mean "value in exchange", with the assumption that a market sets the same prices for physically similar properties in similar locations in the same geographic area within a given period of time. Thus, to account for some of the peculiar characteristics intrinsic in special purpose properties which render the determination of market value difficult, The Assessment Act lays down special procedures to be followed in their valuation.

Outside of this, special valuation may also be rationalized on the ground that adopting certain types of valuation methods tends to offset some of the problems of "market value" assessment in the absence of objective sales data. It is interesting to note that on two or three types of special assessment properties, The Assessment Act has attempted to circumvent the problem of "market value" by way of a notional (i.e. hypothetical) sales method or a combination of income method

and statutory rating. The notional sales approach is applied to assessable railway buildings and structures. Telegraph and telephone companies, on the other hand, are now subject to a 5% straight tax on gross receipts, pipelines are assessed according to a set of statutory rates which are related to lineal length and diameter. (Note: These rates are continually being reviewed and updated.)

A Working Definition

In light of the foregoing survey of a relatively complex field, a tentative working definition of special assessment properties may be offered:

1. Special purpose properties constitute a distinct realty category in that special legislation is generally required to account for their different assessment requirements. In this respect, valuation bases and procedures are either outlined in specific Acts or treated separately under individual sections of The Assessment Act.

2. Special purpose properties can also be distinguished on the basis of their non-convertible character. In other words, these properties are designed or built for a particular service function which cannot be readily converted for others.

3. On an operational level, these properties are valued according to either one or two of the methods set out below:-

(i) Statutory rates in the form of value per measure unit, expressed in actual dollar terms. This form of rating is applied to transmission pipelines which are assessed in lineal feet and to Hydro Electric transformer and generating stations which are assessed in square feet.

(ii) Gross receipts straight tax in the form of a pre-determined percentage of gross income revenue, as applied to certain communications industries.

(iii) Fixed assessment as in the case of golf course lands which are valued at rates determined by a municipality for a defined period.

4. And finally, from a strict assessment stand point, these properties have been considered "special" on the basis that their valuation methods are not included in the Assessment Valuation Manual. Needless to say, this distinction is somewhat arbitrary. Further, the criterion of inclusion will change in time as the Manual is continually being developed, expanded, revised and updated.

Trends and Forseeable Developments

Before we anticipate future developments, it is useful to recount the factors which make the valuation of special assessment properties problematical:

1. Their unique land requirements, their inter-municipal character, their variety, complexity and the special nature of their real estate holdings. This is compounded by the lack of a market which would allow comparative sales appraisal.

2. It is virtually impossible to value most such properties in an equitable manner on a municipality by municipality basis.

3. It is difficult to obtain the required realty information on a standardized basis in order to value the property in total. These issues can bear some elaboration.

The problem of realty information is related to land. Land occupied by transportation or communications companies has usually been owned by them for a long time. Railway lines, for example, commonly predate the commercial and industrial development that now surrounds them. Some of these developments may be related to the railway; others may be quite independent of it. Furthermore, the real estate interests of transportation and communications enterprises usually involve some form of ownership, however limited. Over the years, because these special assessment properties rarely change hands, market value can scarcely, if ever, be derived from actual sales information. In addition, recent changes in the technological base of these industries tend to place unique stresses and strains on their land holdings and render their "market value" unstable.

And finally, a transportation or communications enterprise may continue to hold certain lands that have become of very little value to it for lack of a buyer for property of such specialized shape and character. Or land may be held by a railway because the Board of Transport Commissioners will not permit the company to abandon a particular route. These and other considerations drive home the need for some reform.

The Ontario Committee on Taxation, 1967, made a number of recommendations in its report which related to the valuation of "special" assessment properties. The "special" properties with unique problems for valuation as conceived by the Committee were transportation and communication properties which are subject to special valuation provisions in The Assessment Act or Power Commission Act and which may, or may not, pay taxes (make payments in lieu of taxes) on the same basis as industrial property generally.

Subsequent to the provincial takeover a Committee with provincial, municipal and industrial representation was struck to make recommendations to the then Minister of Municipal Affairs with respect to the assessment and taxation of "special" properties. The Committee identified four major ares of concern: machinery; pipelines; railways and Ontario Hydro; and telephone, telecommunications and cablevision.

As a result of the reorganization of the Ontario Government in 1972, the Assessment Division and the Municipal Finance Branch were separated into the Ministry of Treasury, Economics and Intergovernmental Affairs and the Ministry of Revenue. This made it necessary to reconstitute the Committee and in the fall of 1972, the Task Force on Assessment and Local Taxation was established. The responsibilities of this Task Force were to carry on the work of the former Minister's Committee and its terms of reference were defined as follows:

(i) The Task Force shall be made up of four members, two each from the Ministries of Revenue and Treasury, Economics and Intergovernmental Affairs, under the Chairmanship of Mr. A. N. MacKay, Director of the Assessment Standards Branch, Ministry of Revenue.

(ii) The Task Force will examine any area of assessment and taxation with which problems of assessment and/or taxation are being experienced. This would include a number of areas already being examined by the Minister's Committee such as certain transportation and communication properties, mobile homes, cable television systems.

(iii) The Task Force, in proposing assessment and taxation systems, would be constrained by ensuring that their recommendations are:

(a) within the legislative authority of the Province;

(b) administratively straightforward both as to assessment and taxation;

(c) equitable in that similar properties be assessed and taxed in a similar manner.

Conclusion:

This section of the lesson material has attempted to provide some background information regarding the assessment of special properties. Many recent changes, especially those geared to re-assessment valuations, have attempted to iron out the obvious problem areas. The Task Force is still operating in its function to deal effectively and equitably with these properties.

It is important that all assessors be aware of the intricate valuation problems and techniques that are involved when dealing with these property types.

An explanation of the valuation decisions and how they relate to the legislation can be found on pages 10 to 18 of the 1974 Assessment Standards Branch publication "The Assessment Act - An Interpretation".

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